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Appellate Review in Bankruptcy

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NOTES

Appellate Review Where District Court's Findings Are in Conflict With the Findings of the Referee In Bankruptcy or a Federal Master[1]—What is the extent of review in the United States Courts of Appeals where the district judge has rejected the findings of the referee in bankruptcy pursuant to General Order 47[2] or the master's findings pursuant to Federal Rule 53 (e) (2)?[3]

On this issue a controversy prevails among the appellate tribunals. Does the appellate court occupy the same position as the district judge in determining whether there was error in the referee's or master's findings? Some decisions declare that the appellate court does; others, that it does not and has only the power to determine whether the district judge abused his discretion in upholding or overruling the referee's or master's findings.[4]

Assume that a voluntary petition in bankruptcy is filed in the United States District Court. The district judge adjudicates the petitioner a bankrupt and refers the matter to a referee in bankruptcy. The referee conducts a hearing in accordance with the bankruptcy act. In due course a date is set for filing objections to the bankrupt's discharge and for his discharge. A creditor files an objection to the discharge on the grounds that the bankrupt has made a transfer of his property within twelve months immediately preceding the filing of the petition in bankruptcy with an intent to defraud his creditors.[5] The referee

[1] It should be noted by the reader that the principles of review discussed in the cases cited subsequently apply equally where master's findings or referee's findings are rejected by the district judge. See 5 Moore, Federal Practice §5312(6) at 2995 (2d ed. 1951). Also United States of America v. Twin City Power of Georgia, 253 F. 2d 197 at 206 (5th Cir. 1958).

[2] General Order 47, 11 U.S.C.A. following Sec. 53 states:

Reports of Referees and Special Masters

Unless otherwise directed in the order of reference the report of a referee or of a special master shall set forth his findings of fact and conclusions of law, and the judge shall accept his findings of fact unless clearly erroneous. The judge after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.

[3] Fed. R. Civ. P. 53 (e) (2) states: In non-jury actions. In an action to be tried without a jury the court shall accept the master's findings of fact unless clearly erroneous . Within ten days after being served with notice of the filing of the report any party may serve written objections thereto upon the other parties. Application to the court for acton upon the report and upon objections thereto shall be by motion and upon notice that is prescribed in rule 6 (d). The court after hearing may adopt the report or may modify it or may reject it in whole or in part or may receive further evidence or may recommit it with instructions.

[4] 8 REMINGTON BANKRUPTCY §3442 at 343 (6th ed. 1955).

[5] 11 U.S.C.A. §32 (c) (4) (C) provides: The Court shall grant the discharge unless satisfied that the bankrupt has (4) At any time subsequent to the first day of the twelve months, immediately preceding the filing of the petition in bankruptcy, transferred, removed, destroyed, or concealed, or permitted to be removed, destroyed or concealed, any of his property, with intent to hinder, delay, or defraud his creditors.

hears the evidence and makes findings of fact. On the basis of these findings he makes a ruling discharging the bankrupt. An appeal is taken pursuant to General Order 39 (c),[6] and the record is certified to the district judge. The district judge sustains the objection to the discharge and rejects the findings of the referee making contrary findings, thereby denying the application for discharge. The bankrupt appeals to the United States Court of Appeals. This then is the issue, *i.e.*, is the appellate court in the same position as the district court, thereby having a broad power of review or is its power of review restricted to determining whether the district judge's ruling is clearly erroneous?

The two leading advocates of the diverse rules are the Second and Fourt Circuits. The Second Circuit has adopted a broad and liberal rule as to the extent of appellate review. The rule in the Second Circuit was stated succinctly by Judge Learned Hand in *Morris Plan Industrial Bank v. Henderson:*[7]

> General Order 47, 11 U.S.C.A. following section 53, requires the judge to 'accept his (the referee's) findings of fact unless clearly erroneous.' These are the same words as those used in Rule 53 (e) (2), 28 U.S.C.A. following section 723c, and substantially the same as those in Rule 52 (a)[8] which requires us not
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> 'to set aside' the findings of a judge unless it too is 'clearly erroneous.' It is true that logically a distinction can be drawn between holding a referee's findings to be 'clearly erroneous' and holding a judge's findings that a referee's finding is 'clearly erroneous' to be 'clearly erroneous.' Possibly the Seventh Circuit meant to make that distinction in a case that arose under General Order 47 before it was amended.[9] We should regret,

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[6] General Order 39c, 11 U.S.C.A. following Sec. 53 states: A person aggrieved by an order of a referee may, within ten days after the entry, thereof or within such extended time as the court may for cause shown allow, file with the referee a petition for review of such order by a judge and serve a copy of such petition upon the adverse parties who were represented at the hearing. Such petition shall set forth the order complained of and the alleged errors in respect thereto. Upon application of any party in interest, the execution or enforcement of the order complained of may be suspended by the court upon such terms as will protect the rights of all parties in interest.

[7] 131 F. 2d 976 (2d Cir. 1942).

Fed. R. Civ. P. 52 (a) provides in part: Effect. In all action tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall (similarly) set forth the findings of fact and conclusions of law which constitute the grounds of its action. Request for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of thhe trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them shall be considered as the findings of the court if an opinion or memorandum of a decision and conclusions of law appear therein. . . .

[9] In Re Durvall, 103 F .2d 653 (7th Cir. 1939).

> however, to be compelled now to introduce such refinements into the solution of what is after all only a practical problem. Everyone forms his conclusions from testimony, not from the words which he hears the witnesses utter but from their appearance when they utter them; and the added weight to be attached to a referee's finding, or to a judge's (if he sees the witnesses) depends upon the fact that he has in effect had evidence before him which cold print does not preserve. So far, therefore, as the words themselves leave any latitude, the referee's conclusion ought to prevail because we cannot appraise the cogency of the lost evidence. In the end, as we have often said, the responsibility for the right conclusion remains the judge's as indeed it does ours;[10] but we have again and again held that except in plain cases he should accept the referee's finding.[11] We therefore hold that the question is the same in this court as it was in the district court.

The Fourth Circuit has adopted the restrictive or limited rule in regard to the extent of appellate review. The rule was expressed by Chief Judge Parker in *Mutual Savings and Loan Association v. McCant.*[12] He said:

> We think that we should say, however, that it is the District Judge, not the referee, whose action is reviewed by the court. While we may not give to the finding of a District Judge reversing a finding by a referee as great weight as where the findings of the two are in accord,[13] we are not justified in ignoring the fact that the District Judge has passed on the matter. When he passes upon it, the finding which results is his, not that of the referee: and it is his finding, not the referee's, which we review, and we review it under no presumption that the referee and not the judge, was the one who was right. Weight is to be accorded, of course, to the fact that the referee saw and heard the witnesses; but weight must also be given to the fact that it is in the judge that final judicial power in the District Court is vested, that he is ordinarily a man of sound judgment and wide experience and that action on his part reversing a referee is ordinarily taken only after careful consideration. To say that when he reverses the referee we must pass upon the latter's action just as though it had not been reversed and must sustain it unless clearly wrong without reference to what the judge has found, is to prescribe a rule of review which, in our opinion, does not accord due weight to the exercise of the judicial function by the District Judge. The correct rule, we think, is that we reverse the finding of the judge, only if in our opinion it is clearly wrong

[10] In Re Kearney, 116 F. 2d 899 (2d Cir. 1940).
[11] In Re Slocum, 22 F. 2d 282 (2d Cir. 1927).
In Re Gordon & Gelberg, 69 F. 2d 81 (2d Cir. 1934); In Re Goldner Seigel Corporation, 71 F. 2d 152 (2d Cir. 1934); In Re Wisun & Goluv, Inc., 84 F. 2d 1 (2d Cir. 1936).
[12] 183 F. 2d 423 at 426 (4th Cir. 1950); see also Mountain Trust Bank v. Shifflett, 255 F. 2d 718 (4th Cir. 1958).
[13] Gregory v. Baer, 149 F. 2d 411 (4th Cir. 1945).

> and that, in making this decision, we should properly take into account, for what upon the record it may be worth, the fact that the referee, who had the advantage of seeing and hearing the witnesses, took a contrary view from the judge.

WHAT IS THE RULE IN THE OTHER CIRCUITS?

The Seventh Circuit is alleged to be the originator of the narrow or restricted view,[14] but it appears from decisions cited subsequently that the restrictive rule has been abandoned in favor of the liberal rule advocated by Judge Learned Hand. The restrictive rule was first enunciated in the case of *In re Duvall.*[15] There a petition was filed by a person claiming ownership in certain property which the bankrupt claimed to own. The referee denied and dismissed the petition and on appeal the district judge sustained the petitioner's exceptions to the referee's report. In discussing the extent of review the appellate court stated:

> The argument presented here indicated that counsel, erroneously we think, assumed that this is a trial *de novo.* Ordinarily this court sits merely in the capacity of review and is bound by the findings of the lower court where the same is supported by substantial evidence, notwithstanding the fact that we might have reached a different conclusion on a matter submitted to us as an original proposition. . . .[16]

Further on the court states:

> Of course the judgment exercised by the court must not be arbitrary, but where there are facts and circumstances concerning which reasonable minds might differ, we think the court, after indulging in the presumption which the rule accords the Referee's report, may exercise its judgment even though it be contrary to the finding as made by the Referee, and when the court's judgment has been thus exercised, we do not think we are at liberty to disturb the same except where we might conclude there was no substantial evidence or theory which would justify the court in reaching a conclusion contrary to the Referee.[17]

However the restrictive rule was abandoned and the liberal rule adopted by the Seventh Circuit in *In re Skrentny.*[18] In that case the court determined that General Order 47 applied equally to the district and appellate court. The court appears to have liberally interpreted the word *Judge* in General Order 47 to mean both district and appellate judge whereas the courts applying the narrow rule interpret General Order 47 literally and hold it applicable only to the district judge.

[14] 8 REMINGTON BANKRUPTCY §3444 (6th ed. 1955).
[15] In Re Duvall *supra* 9, also see In Re United Finance Corporation, 104 F. 2d 593 (7th Cir. 1940).
[16] *Id.* at page 655.
[17] *Op. cit.* at 656.
[18] In Re Skrentny, 199 F. 2d 488 at 492 (7th Cir. 1952).

This same rule was announced in the Seventh Circuit when a district judge rejected a master's findings.[19] An action was brought for alleged wrongful appropriation by the defendant of plaintiff's secret process for manufacture of an iron chemical. The issue was referred to a special master, who in his report found the equities to be with the plaintiff and recommended that the defendant be ordered to account. Sustaining some of the defendant's objections to the special master's report, the district judge held the findings and conclusions covered thereby clearly erroneous and dismissed the cause for want of equity. On appeal the appellate court speaking of the extent of review stated: "The threshold question here then is the same as it was in the Court below,—whether, as a matter of law, the master's findings of fact were clearly erroneous."[20]

Thus it appears that the Seventh Circuit has clearly adopted the liberal rule.

The Eighth Circuit underwent the same type of a transition as that of the Seventh Circuit. In a proceeding in the matter of a farmer debtor, under the Bankruptcy Act, two federal agencies, as secured creditors, filed a petition for review of the Conciliation Commissioner's valuation of the land.[21] The district judge sustained their objection and held that the commissioner's findings were clearly erroneous. Speaking of the extent of review granted on appeal, the appellate court said:

> Our only power and duty in the situation presented here is to test whether the result which now has been reached by the District Judge's exercise of his authorized function is itself clearly erroneous. On the record before us, we cannot declare the value fixed by the District Judge to be clearly erroneous. The fact that some other equally sustainable result might have been reached on the evidence is beside the point.[22]

In a subsequent decision involving a master's findings which were rejected by the district judge, the court of appeals cited *Morris Plan Industrial Bank v. Henderson*[23] and held that the question on review in the appellate court is the same as it was in the court below, *viz.*, whether the master's findings were entitled legally to be declared clearly erroneous. In adopting the broad rule the court appeared to emphasize that a master and not a district judge was the initial appraiser of the facts. When the initial determination in judicial administration is at a level below the district court; there appears to be no reason why the appellate court should be restricted to determining whether the district

[19] Ferroline Corporation v. General Aniline and Film Corporation, 207 F. 2d 912 (7th Cir. 1953); also see Krinsley v. United Artists Corporation, 225 F. 2d 579 at 582 (7th Cir. 1955).
[20] *Id.* at 920.
[21] Rait v. Federal Land Bank of St. Paul et. al., 135 F. 2d 447 (8th Cir. 1943).
[22] *Id.* at 451.
[23] *Supra* note 7.

judge had abused his discretion.[24] It appears that the Eighth Circuit has made a complete turn in rejecting the restrictive rule and adopting the liberal rule.

The Fifth Circuit clearly manifests the diversity between the two views. Judge Hutcheson in *Phillips v. Baker*[25] strongly advocated the liberal rule; and in a well written decision elucidated the underlying reason for adopting the liberal rule. Judge Hutcheson said there:

> We are, on the contrary, dealing with findings made by the district judge, adverse to those of the referee, in respect to matters primarily remitted for decision to the referee and as to which it is provided that the judge shall acept his findings of fact unless 'clearly erroneous'. Under that rule, we have the same duty as the district court to accept the referee's findings unless they are 'clearly erroneous'. Under that rule, we, of course, take into consideration the fact that the district judge has refused to accept the referee's findings. But we do so not in determining whether the district judge's findings are clearly erroneous for that is not the matter before us. We do it in determining whether the referee's findings are, and we do this with the clearest recognition that the duty to determine whether the referee's findings 'must be accepted' and whether the district judge erred in not accepting them is not the district judge's but ours.[26]

The cogency of the last cited decision would appear to make it immutable. However in a recent condemnation proceedings initiated in a district court of Georgia the rule was overturned.[27] In that case, the district judge appointed three commissioners under Federal Rule 71 (h)[28] to appraise the value of the land. The commissioner's findings as to the value of the land were rejected by the district judge as being clearly erroneous. The district judge made his own findings and entered judgment accordingly. The judgment was appealed and the appellate court was presented with the question of the extent of its review. The government argued that the question before the court was whether the findings of the commissioners were clearly erroneous citing *Phillip's v. Baker.*[29] The court rejecting the government's contention held that the questions on appeal are: "(1) whether the district court applied the proper standard in considering the findings; (2)

[24] Sanitary Farm Dairies v. Gamel, 195 F. 2d 106 at 114 and 118 (8th Cir. 1952).
[25] 165 F. 2d 587 (5th Cir. 1948).
[26] *Id.* at 581.
[27] United States of America v. Twin City Power of Georgia, 253 F. 2d 197 (5th Cir. 1958).
[28] Fed. R. Civ. P. 71 (h) states: Trial. If a commission is appointed it shall have the powers of a master provided in subdivision (c) of Rule 53 and proceeding before it shall be governed by the provisions of paragraph (1) and (2) of subdivision (3) of Rule 53. Its actions and reports shall be determined by a majority and its findings and report shall have the effect, and be dealt with by the Court in accordance with the practice, prescribed in paragraph (2) of subdivision (c) of Rule 53. Trial of all issues shall otherwise be by the court.
[29] Phillips v. Baker, *supra* note 25.

whether it erred in rejecting the findings of the commissioners as clearly erroneous; and (3) whether, in turn, the findings made by the district court are clearly erroneous." It clearly appears that the court adopted the restrictive rule, *viz.*, the appellate court has only the power to determine whether the district judge abused his discretion in upholding or overruling the referee's or master's findings. Circuit Judge Tuttle in a vigorously written dissenting opinion took issue with the majority's opinion on the extent of the appellate review.[30] He observed that the decision of *Phillips v. Baker* was decided in the Fifth Circuit and that the holding of the majority, adopting the rule of the Fourth Circuit is contrary to the otherwise unbroken line of decisions of appellate courts which have dealt with this problem. The dissent appears to clarify the difference between the restrictive and liberal rule. The rationale being that although the majority did hold that the district judge did not abuse his discretion in rejecting the commissioners' findings as clearly erroneous, they were not prepared to say that the commissioners' findings were clearly erroneous and that they would set them aside.

This would appear to manifest that there is an intrinsic disparity between the liberal and the restrictive rule of review and that it is more than quibbling over what "verbal alibi" the court desired to select in explaining why it took a course of action which it would have taken in any event as has been suggested by one of the leading treatises on bankruptcy.[31] It would be mere speculation to attempt to state which rule will be adhered to when the question next arises in the Fifth Circuit.

In the remaining Courts of Appeals the controversy on the extent of appellate review has not been discussed as such. However, the Courts of Appeals for the First, Third, Sixth, and Ninth Circuits and the District of Columbia apparently have adopted the liberal rule enunciated by Learned Hand. The decisions are not explicit in regard to the extent of appellate review but the underlying rationale is that of *Morris Plan Industrial Bank v. Henderson.*[32] There is no indication that the Tenth Circuit has discussed the precise question in issue.[33]

CONCLUSION

A recent note in the *Journal of the National Association of Referees*

[30] *Supra* note 27 at 206.
[31] 8 REMINGTON BANKRUPTCY §3442 at 343 (6th ed. 1955).
[32] *Supra* footnote 7. See McDonald v. First National Bank of Attleboro, 70 F. 2d 69 (1st Cir. 1934); In Re Wolf, 165 F. 2d 707 at 710 (3d Cir. 1948); Anderson v. Mt. Clemens Pottery 149 F. 2d 461 (6th Cir. 1945); Smith v. Federal Land Bank of Berkley, 150 F. 2d 318 (9 Cir. 1945); Kal Lines v. Falstaff Brewing Co. et. al., 233 F. 2d 927 (9th Cir. 1956); International Silk Guild Inc. v. W. P. Rogers, 262 F. 2d 219 at 224 (D. C. Cir. 1958).
[33] *Cf.* In Re Ben Boldt, Jr. v. Terasaki et. al., 37 F. 2d 499 at 502 (10th Cir. 1930); Alexander v. Thelemen, 69 F. 2d 610 (10th Cir. 1934).

in Bankruptcy took cognizance of the two diverse rules of appellate review where the referee's or master's findings are rejected by the district judge.[34] The writer cited the two leading cases advocating the diverse views, and then stated on the basis of the ultimate decision in those cases: "Perhaps the difference is more apparent than real."

This appears to be begging the question rather than clarifying the disparity. It appears to this writer that the two rules are categorically adverse and the reason being a different interpretation of the germane rules.[35]

The Fourth Circuit advocates a restrictive rule of review on the basis of a literal interpretation of Federal Rule 52 (a) and the fact that the district judge is the final judicial power in the district court. The decisions of the Fourth Circuit take cognizance of the fact that the district judge is ordinarily a man of sound judgment and wide experience and that action on his part reversing a referee or master is ordinarily taken only after careful consideration. The reasoning of the Fourth Circuit appears to be that the district judge is presumably cognizant of the "unless clearly erroneous rule" requirement of General Order 47 and Rule 53 (e) (2) and Federal Rule 52 (a) which commands the appellate court not to set aside the district court's findings of fact unless clearly erroneous.[36]

The broad rule of review as advocated by the Second Circuit appears to be based upon a pragmatic approach to the problem, the rationale being that logically there is a distinction between holding a referee's findings to be "clearly erroneous" and holding that a judge's findings that a referee's finding is clearly erroneous is erroneous.

The refinement made by the advocates of the restrictive rule is of no practical value. It is at most merely pedanticism. Under the circumstances present, the district judge is not the initial appraiser of the facts. Therefore, there would seem to be no reason why the appellate court should be restricted to merely determining whether the district judge abused his discretion in holding the initial findings clearly erroneous. General Order 47 and Federal Rule 53 (e) (2) are given broad coverage so as to include the appellate court, principally because in the opinion of the majority of circuit judges this is the only practical way to conduct a review and to insure that justice will be attained.

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[34] 32 *Journal of the National Association of Referees in Bankruptcy* 120 (October, 1958).
[35] Fed. R. Civ. P. 52 (a) General Order 47, 11 U.S.C.A. following Sec. 53, Fed. R. Civ. P. 53 (e) (2)
[36] United States of America v. Twin City Power Company of Georgia, 253 F. 2d 197 at 203 (5th Cir. 1958).